80-894

No.

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

BECKER'S MOTOR TRANSPORTATION, INC., and NEEDHAM'S MOTOR SERVICE, INC., Debtors,

Petitioners,

vs.

DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Questions Presented

Are the rehabilitative purposes of the bankruptcy laws defeated by permitting the post-confirmation collection of undisclosed assessments of penalties and interest by the Internal Revenue Service (IRS) when the IRS fully participated in the bankruptcy court proceedings and accepted full pyament of the tax claims it asserted therein?

May the bankruptcy court use its equitable injunctive powers to enjoin IRS' post-reorganization efforts to collect penalties and interest that were not asserted or disclosed during the bankruptcy proceedings?

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No.

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OCTOBER TERM, 1980

BECKER'S MOTOR TRANSPORTATION, INC., and NEEDHAM'S MOTOR SERVICE, INC., Debtors,

Petitioners,

vs.

DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The petitioners, Becker's Motor Transportation, Inc., and Needham's Motor Service, Inc., Debtors pursuant to Chapter XI of the Bankruptcy Act of 1898, as amended, 11 U.S.C. § 1, *et seq.*, respectfully pray that a writ of certiorari issue to review the judgment and opinion of The United States Court of Appeals for the Third Circuit entered in this proceeding on September 4, 1980.

Opinions Below

The opinion and judgment of the Court of Appeals for the Third Circuit, the opinion and order of the District Court for the District of New Jersey and the orders of the Bankruptcy Court for the District of New Jersey appear in the Appendix hereto.

Jurisdiction

The judgment of the Court of Appeals for the Third Circuit was entered on September 4, 1980, and this petition for certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Federal Statutes Involved

(1) Section 17(a)(1) of the Bankruptcy Act (formerly codified at 11 U.S.C. §35(a)(1)), which provides:

> a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the

bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this Act: *And provided further,* That a discharge in bankruptcy shall not release or affect any tax lien.

(2) Sec. 7421(a) of the Internal Revenue Code of 1954, 26 U.S.C. § 7421(a), which provides:

> Tax.—Except as provided in sections 6212(a) and (c), 6213(a), 6672(b), 6694(c), 7426(a) and (b)(1), and 7429(b), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

As amended Nov. 10, 1978, Pub. L. 95-628, § 9(b)(1), 92 Stat. 3633.

Statement of the Case

On December 12, 1974, Becker's Motor Transportation and Needham's Motor Service, Inc., ("debtors") filed petitions for an arrangement under Chapter XI of the Bankruptcy Act of 1898, formerly codified at 11 U.S.C. §1, *et seq.* On October 21, 1975, the Internal Revenue Service ("IRS") filed a proof of priority claim for internal revenue taxes against each of the debtors in the total sum of $81,-857.04. A motion to reduce a portion of the IRS claim was filed, and negotiations between counsel for the debtors and the IRS were conducted regarding the claim. As the result of the negotiations, the IRS chose to withdraw one of its original claims and to file an amended proof of claim on April 5, 1977, thereby reducing the total of claims filed to $74,792.04.

After 23½ months of negotiations between the debtors, various creditors (including the IRS), their attorneys, and the appointed creditors' committee, a Joint Plan of Arrangement under Chapter XI of the Bankruptcy Act was confirmed and approved, upon notice to all creditors, including the IRS, by the bankruptcy court on December 1, 1976. On June 30, 1977, an Order of Distribution for Priority Creditors authorized full payments to the IRS of its priority tax claim of $74,792.04.

Payments in full to the IRS were made and accepted shortly thereafter. Additionally, payment was made to over 450 creditors who participated in the Joint Plan. The estate was thereafter closed by order of the bankruptcy court. At no time during the arrangement proceedings did the IRS assert, notify or advise the debtors or their attorneys of the possibility that it would thereafter seek to collect additional monies for penalties and interest on the taxes for which the government had claimed and accepted full payment during the arrangement proceedings.

In September 1977, shortly after payment of its $74,-792.04 tax claims and after the estate had been closed, the IRS gave the first notice of its intention to assert and collect additional monies for penalties and interest by instituting collection activities against the debtors through one of its revenue officers. Thereafter, on January 13, 1978, the IRS issued a 10-day notice letter to the debtors, which set forth a schedule of unpaid "accumulated" interest and penalty charges totaling $34,960.14. The IRS advised the debtors that unless payment was made within 10 days, enforcement action would commence. At the same time, the IRS filed notices of federal tax lien against the debtors. These notices revealed, for the first time, that all the assessments for interest and penalty claims which had been made by the IRS were known before October 21, 1975, the date it filed its proofs of tax claims in the Chapter XI proceedings. The IRS had made an internal determination as to the amount it would assess for interest and penalties prior to the time it filed its proofs of tax claims. However, despite the IRS's knowledge of the assessed amounts, it failed to communicate the assessments to the debtors, until after the Chapter XI proceedings had ended, either by separate communication or through its filed proofs of claim.

Because the IRS never asserted its assessed penalty and interest claims in the bankruptcy proceedings, the debtors sought and obtained an order reopening the Chapter XI proceedings for the purpose of considering IRS's right to the asserted penalties and interest. On the same date, the debtors filed a complaint for a stay of the collection activities of the IRS, and obtained an order of the bankruptcy court preliminarily staying the collection activities of the IRS pending a hearing on their complaint.

On February 28, 1979, the bankruptcy court denied the IRS' motion to dismiss for lack of jurisdiction and granted the debtors' motion for summary judgment. (App. E & F, *infra,* pp. 31a-35a). The bankruptcy court ruled on the basis of the uncontroverted facts that, due to the IRS' silence as to its intention to collect interest and penalies during the entire Chapter XI proceedings, it was thereby estopped from such collection efforts, and deemed to have waived its claims. On appeal, upon analysis of the entire record and the applicable legal principles, the district court affirmed, concurring in the judgment below. (App. C, *infra,* pp. 23a-28a).

The Court of Appeals for the Third Circuit vacated the judgment of the district court and remanded, directing the district court to remand to the bankruptcy court with instructions to allow collection of the pre-petition penalties and post-petition interest from the arranged debtors, and to disallow collection of pre-petition interest. (App. A, *infra,* p. 19a). The Third Circuit also reversed that portion of the district court order which upheld the issuance of an injunction by the bankruptcy court. (App. A, *infra,* p. 19a).

In a concurring opinion, Chief Judge Seitz disagreed with that portion of the majority's opinion holding that the bankruptcy court lacked the power to grant injunctive relief under the circumstances. (App. A, *infra,* pp. 19a-20a).

REASONS FOR GRANTING THE WRIT

I. There is a direct conflict between circuits on two significant issues affecting debtors who have been rehabilitated pursuant to the federal bankruptcy laws.

A. The decision below is in direct conflict with the Eighth Circuit's holding that the IRS is barred from the collection of post-petition interest and penalties under virtually identical factual circumstances.

In the present case, both the bankruptcy court and the district court specifically found that the debtors, in proposing their joint plan of arrangement, relied upon the IRS' actions in the bankruptcy proceedings, including its negotiations and acceptance of $74,792.04 as payment in full. The Third Circuit agreed that such reliance was present here. Moreover, all of the courts recognized that the bankruptcy court itself relied upon the settlement of the amounts of the IRS' claim in concluding that the plan was feasible. All of the courts further concurred that permitting post-reorganization assertion and collection of penalties and interest would seriously jeopardize the financial stability of the debtors. As the Third Circuit pointed out:

> The absence of bankruptcy court jurisdiction to ascertain debtor liability *could result in the confirmation of a plan of arrangement that the court might have deemed infeasible* had it been able to take into account the future liability of the debtor. *Such a result would be at odds with the intent of Congress* in conferring bankruptcy court jurisdiction to effecutate debtor rehabilitation under Chapter XI. (Emphasis added).

(App. A, *infra*, p. 6a, fn.2).

Notwithstanding the foregoing, the Third Circuit held that the IRS was not barred from the collection of post-petition interest and pre-petition penalties. In so holding, the Court of Appeals concluded that the debtors had misconstrued the law in assuming that consummation of their plan of arrangement would satisfy all of the IRS' claims against them, including interest and penalties, that reliance on such assumption was unjustified, and therefore, that such reliance could not operate to estop the IRS' post-consummation collection of pre-petition penalties and post-petition interest.

In re Aristo Foods, Inc., Nos. 77-1931 and 78-1216 (8th Cir. 1978)[1] reached the opposite conclusion upon factual circumstances so similar to the present case that they are without relevant distinction. (App. G, *infra,* pp. 36a-38a). In *Aristo,* the IRS collected nearly $120,000 in back taxes during the arrangement proceedings and failed to reveal its intention to collect an additional $40,000 in interest and penalties until some five months after confirmation. The Eighth Circuit found that IRS had accepted the amount claimed and paid pursuant to the plan of arrangement in satisfaction of the total debt. Affirming on the basis of the district court's opinion, the Eighth Circuit barred the IRS from the collection of interest and penalties under the theories of waiver and estoppel.

The relevant factual circumstances in *Aristo* are so parallel to the circumstances in the present case that they merit enumeration herein. In both cases, the Chapter XI proceedings spanned a period of approximately two years,

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[1] The Eighth Circuit affirmed the opinion of the United States District Court for the Western District of Missouri, 3 Bankr. Ct. Dec. 869 (W.D. Mo. 1977), which, in turn, affirmed the United States Bankruptcy Court for the Western District of Missouri, 3 Bankr. Ct. Dec. 476 (W.D. Mo. 1977).

during which time extensive negotiations with creditors occurred with respect to the formulation of an acceptable plan of arrangement. In both cases the IRS was a substantial claimant and its priority claim for unpaid federal taxes was allowed and paid in full. In both cases, the proof of claim filed by the IRS was silent as to its intention to seek post-petition interest, containing no entry in the spaces provided for interest accrued or accruable.[2] At no time during the Chapter XI proceedings in *Aristo* or the case below did the IRS advise the debtors or their attorneys of its intention to seek collection of penalties or interest from the debtors after consummation of their Chapter XI plan. In both cases the plan of arrangement which was proposed, accepted and confirmed was based upon the sum known to be due to the government for taxes, with all parties (including the bankruptcy court) operating on the understanding that the amount of the filed proof of claim would be the total amount of the IRS' claim. Finally, in both cases, all steps taken by the debtors in consummation of the plan of arrangement were based upon the amount paid to the IRS as the largest creditor under the plan, and the IRS did not reveal its intention to claim additional monies or begin collection activities therefor until *after* it received full payment for all taxes claimed under the plan.

The decision below presents a patent conflict between the circuits on a question of fundamental importance to debtors who have sought and obtained the rehabilitation made possible by Congress through the bankruputcy laws, only

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[2] The Third Circuit's reliance in the decision below upon its prior decision in *Hugh H. Eby Co.* v. *United States,* 456 F.2d 923 (3d Cir. 1972), is misplaced, because in *Eby* the IRS gave notice of its intention to seek post-confirmation collection of post-petition interest by specifically including a claim therefor in its proof of claim filed in the bankruptcy proceedings.

to see that renascence stunted or destroyed by inequitable procedures of the IRS. In such circumstances, the grant of certiorari to review the judgment below is mandated.

B. The decision below is in direct conflict with the Eighth Circuit's decision upholding the bankruptcy court's jurisdiction under the Bankruptcy Act to issue injunctions against the IRS.

The Third Circuit upheld the bankruptcy court's authority to reopen the Chapter XI proceedings pursuant to specific provisions of the Bankruptcy Act and Rules in order to provide "relief" to the debtors by adjudicating the question of their post-consummation "personal liability" for penalties and interest on the paid and satisfied tax debt. The Third Circuit, however, held that the bankruptcy court was prohibited from enjoining the IRS' collection efforts by application of 26 U.S.C. §7421(a), the so-called "anti-injunction" statute.

The district court below affirmed the bankruptcy court's issuance of an injunction against the IRS collection efforts upon the authority of *Bostwick* v. *United States,* 521 F.2d 741 (8th Cir. 1975). *Bostwick* represents a comprehensive and careful balancing of the competing policy of the congressional scheme governing bankruptcy and the general policy represented by the "anti-injunction" statute, and concludes that the overriding policy of the Bankruptcy Act to rehabilitate debtors mandates that the bankruptcy court have the power to enjoin the assessment and/or collection of taxes in order to fulfill its ultimate purpose and goal. 521 F.2d at 744-745.[3] The Third Circuit re-

[3] *See also In re Johnson Electrical Corporation,* 442 F.2d 281, 282 (2d Cir. 1971), where the Second Circuit, although finding it unnecessary to rule on the jurisdictional issue, nonetheless states that it has a negative impression of the government's argument that the bankruptcy court lacks the power to enjoin IRS' collection efforts.

versed that portion of the district court's holding which upheld the issuance of an injunction by the bankruptcy court and either ignored or refused to apply the *Bostwick* factors to determine the propriety *vel non* of the bankruptcy court's issuance of an injunction under the circumstances, stating, "we are of the opinion that judicially created exemptions to §7421(a) contravene clear congressional intent. . . ." Chief Judge Seitz, however, departed from the majority opinion on this issue, stating that he agreed with the opinion and rationale of the Eighth Circuit in *Bostwick* (App. A, *infra,* pp. 19a-20a).

This conflict between the circuits reflects a fundamental jurisdictional confusion and question which mandates the grant of certiorari to review the judgment below.

II. The decision below subordinates the rehabilitative purposes of the bankruptcy laws to the collection of penalties and interest by the IRS.

This Court has long and consistently stated that the central purpose of the federal laws governing bankruptcy is the rehabilitation of the debtor. *E.g., Local Loan Co.* v. *Hunt,* 292 U.S. 234 (1934); *Perez* v. *Campbell,* 402 U.S. 637 (1971). The decision of the Third Circuit below condones conduct by the IRS contravening that purpose. The decision below is clearly anti-rehabilitative since it permits the IRS to "lie-in-wait"[4] while the debtor ex-

[4] It has not been unusual for the IRS to give notice of its post-confirmation intention to collect interest and penalties from the rehabilitated debtor. *See, e.g., Hugh H. Eby Co.* v. *United States, supra; Rawson, Inc.* v. *United States of America, Internal Revenue*

(Footnote continued on following page)

tends itself in its efforts to propose and finance an acceptable plan of arrangement. The decision permits (if not encourages) the IRS to ambush the debtor with a claim for interest and penalties at a time in its rehabilitated life which the Supreme Court has described as:

> . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.

Local Loan Co. v. *Hunt, supra* at 244.

Moreover, the decision below constitutes an affront to the jurisdiction of the bankruptcy court. As the Court of Appeals itself acknowledged in the present case,

> [t]he personal liability of a debtor can be a critical factor in the determination by a bankruptcy court whether it is appropriate to confirm a Chapter XI plan of arrangement.

(Footnote continued from preceding page)

Service, 4 Bankr. Ct. Dec. 1245 (W.D. Wash. 1978); *In re Stewart Thomas, Inc.,* 5 Bankr. Ct. Dec. 168 (W.D. Va. 1979). It is also noteworthy that at the time of the argument before the Eighth Circuit in *Aristo,* counsel for the IRS advised the court that a proposal was pending in the National Office of the IRS to change the Internal Revenue Manual to require that although they will not be claimed against the bankrupt estate, all interest and penalties be stated on the proofs of claim filed in bankruptcy proceedings. A similar proposal was apparently put into effect by the New England Regional Office as a result of the decision in *In re Adams/Fredrickson Associates, Inc.,* 3 Bankr. Ct. Dec. 179 (D. Me. 1977).

Perhaps more significant is the concession made by the Third Circuit below, concurring in the statement of the Second Circuit in *In re Jaylaw Drug, Inc.,* 621 F.2d 524, 529 (2d Cir. 1980), that the IRS is well advised to prepare proof of claim forms which adequately represent its intentions with respect to the post-confirmation collection of interest and penalties. (App. A, *infra,* p. 16a, fn. 13).

(App. A, *infra*, p. 6a, fn. 2). By condoning the misleading nature of the IRS' failure to notify the court of post-confirmation claims which it might assert against the debtor, the decision below effectively prevents a fair evaluation of the debtor's ability to succeed after the chapter proceeding. The bankruptcy court is forced to determine feasibility in a vacuum. It is therefore incumbent upon this Court to preserve the integrity of the bankruptcy court and to protect the interests of debtors who have sought and obtained the protection and rehabilitation of the bankruptcy laws.

III. The decision below conflicts with other decisions in interpreting the breadth of the United States Supreme Court's holding in *Bruning* v. *United States*, 376 U.S. 358 (1964).

This Court granted certiorari in *Bruning* to resolve a conflict between the Ninth and Tenth Circuits concerning the liability of a discharged bankrupt for post-petition interest on its undischarged tax liability.[5] *Bruning* was a refund suit filed in federal district court by a discharged bankrupt seeking recovery of post-petition interest paid on an unpaid, undischarged tax debt. Sus-

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[5] The Ninth Circuit's decision in *Bruning*, 317 F.2d 229 (9th Cir. 1963), sustained the collection of post-petition interest from a discharged bankrupt while the Tenth Circuit in *United States* v. *Mighell*, 273 F.2d 682 (10th Cir. 1959), found to the contrary. *See also National Foundry Company of New York* v. *Director of Internal Revenue*, 229 F.2d 149 (2d Cir. 1956), relying on the Second Circuit's decision in *Sword Line* v. *Industrial Commissioner of State of New York*, 212 F.2d 865 (2d Cir. 1954), *cert. denied* 348 U.S. 830 (1954) for the proposition that claims for interest and penalties do not accrue after bankruptcy.

taining the reasoning of the Ninth Circuit, this Court held that Congress clearly intended under Section 17 of the Bankruptcy Act that personal liability for unpaid tax debts survives bankruptcy and there is no reason to believe it had a different intention with respect to the interest on such debts. 376 U.S. at 361. Thus, *Bruning* stands for the simple proposition that debts which remain undischarged after a bankruptcy proceeding are payable with accrued interest.

In *In Re Johnson Electrical Corporation, supra,* the Second Circuit Court of Appeals applied *Bruning* in the context of a Chapter XI proceeding where the underlying nondischargeable tax debt was fully satisfied by the debtor's plan of arrangement. The same result was reached by the Third Circuit in *Hugh H. Eby Co.* v. *United States, supra.* While *Bruning* provides for the accrual of post-petition interest in the narrow circumstance where the underlying tax debt is both unpaid and undischarged by the bankruptcy proceedings, *Johnson* and *Eby* have extended *Bruning* to encompass the very different situation where the underlying tax debt is both paid and therefore discharged by the debtor's plan of arrangement.[6] Such a result may well not have been intended by this Court.

Clearly, not every court reads this Court's decision in *Bruning* so broadly. *In re Vaughan,* 292 F.Supp. 731 (E.D.

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[6] There is no question that liability for federal taxes is nondischargeable, and therefore survives bankruptcy proceedings. *Bruning* held that where the tax liability continues, so, too, does the interest payable thereon. However, it is not the holding of *Bruning* that interest shall also continue to accrue and be payable by a rehabilitated Chapter XI debtor in the circumstance where the debtor's arrangement proceeding has "provided for" the underlying debt, as that phrase is used in the Bankruptcy Act. *See* Section 371 of the Bankruptcy Act (formerly 11 U.S.C. §771).

Kentucky 1968) distinguishes *Bruning* by perceptively noting that although the taxpayer-plaintiff in *Bruning* initially sought a refund for post-petition interest paid with respect to the portion of taxes which had been paid by the bankruptcy estate, as well as that portion which remained unpaid, the case was appealed only on the question of the bankrupt's liability for interest on the taxes which remained *unpaid* following the bankruptcy proceedings. 292 F. Supp. at 733. Thus, *Vaughan* limits *Bruning* to its true holding: "that post-petition interest on an *unpaid* tax debt not discharged by §17 remains, after bankruptcy, a personal liability of the debtor." *Id.*, citing *Bruning*, 376 U.S. at 363.[7]

The decision of the Third Circuit below obviously relies upon the *Johnson-Eby* extension of *Bruning* to reach the following conclusion:

> "[i]t is well established that obligations for pre-petition penalties and post-petition interest that accrue on a tax debt comprise personal liabilities of the debtor, and survive payment of the principal debt pursuant to an arrangement."[8]

The conflict between the decision below and the *Eby* and *Johnson Electrical* cases upon which it relied on the one

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[7] It is evident from the quoted language that *Bruning* did not hold post-petition interest, as such, non-dischargeable under Section 17 of the Bankruptcy Act, but instead held that post-petition interest accruing on an unpaid tax debt which, under Section 17 is not discharged, remains a "personal liability" of the debtor.

[8] The extension of the *Bruning* rationale with respect to pre-petition penalties, which were not even at issue in *Bruning*, occurred in *World Scope Publishers, Inc.* v. *United States*, 348 F.2d 640 (2d Cir. 1965).

hand, and the decision and rationale in *Vaughan* reflects a fundamental confusion as to the interpretation of the Supreme Court's holding in *Bruning*. In such circumstance the grant of certiorari to review the judgment below is mandated.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Third Circuit.

Respectfully submitted,

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APPENDIX A

Opinion of the United States Court of Appeals for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2796

In the Matter of
BECKER'S MOTOR TRANSPORTATION, INC.,
a New Jersey Corporation with its
principal place of business in the
State of New Jersey,
Debtor (Bankruptcy No. B-74-2050)

In the Matter of
NEEDHAM'S MOTOR SERVICE, INC., a
Delaware Corporation with its
principal place of business in the
State of New Jersey,
Debtor (Bankruptcy No. B-74-2051)

v.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Appellant

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Bankruptcy Nos. B-74-2050 & B-74-2051

Argued July 8, 1980

Before: SEITZ, *Chief Judge*,
ADAMS, *Circuit Judge*, and LORD, *Chief District Judge**

(Filed September 4, 1980)

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*Honorable Joseph S. Lord, III, Chief Judge, United States District Court for the Eastern District of Pennsylvania, sitting by designation.

Appendix A

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OPINION OF THE COURT

ADAMS, *Circuit Judge.*

This appeal from an order of the district court, affirming the issuance by the bankruptcy court of a summary judgment and an injunction in favor of debtors, raises a number of difficult questions regarding the law of bankruptcy. The threshold inquiry is whether the bankruptcy court had jurisdiction to reopen a Chapter XI proceeding to adjudicate the personal liability of a rehabilitated debtor for pre-petition penalties and post-petition interest on a nondischargeable tax debt that had been satisfied pursuant to a plan of arrangement. If the bankruptcy court had jurisdiction, we must

next determine whether it was barred from issuing injunctive or declaratory relief with respect to the collection of taxes assessed after the arrangement was completed. Finally, on the merits we are required to consider whether the Internal Revenue Service was estopped from attempting to collect pre-petition penalties and both pre-petition and post-petition interest.

I. FACTS

On December 12, 1974, the plaintiffs, Becker's Motor Transportation, Inc., and Needham's Motor Service, Inc., filed petitions for an arrangement under Chapter XI of the Bankruptcy Act. The Internal Revenue Service (IRS) filed proofs of claim in the amount of $74,792.04 against the debtors' estate on October 21, 1975 for nondischargeable tax debts and pre-petition interest owed by Becker's and Needham's. In filing the proofs of claim, the IRS left blank the line on the form designated "[D]ollar amount per day at which interest will accrue after date of this statement." After all claims had been filed, the debtors proposed a joint plan of arrangement, which was confirmed by the bankruptcy court on December 1, 1976. In order to obtain sufficient cash for the consummation of the plan, the debtors borrowed over $550,000.00.

Pursuant to an order of distribution issued in conformity with the plan, the tax indebtedness that had been claimed by the IRS was paid in full; nonpriority creditors received payment at the rate of 7½ cents per dollar. Following distribution, the arrangement estate was closed and the debtors resumed business operations. Thereafter, in September 1977, the IRS sought to collect from the rehabilitated debtors $34,960.14 in pre-petition penalties and post-petition interest on the satisfied tax debts. No notice of these claims had been provided during the arrangement.

Appendix A

On May 18, 1978, the debtors applied to the bankruptcy court, which had closed the estate, for an order reopening the proceedings. On the same day, the request was granted and the debtors filed a complaint seeking declaratory and injunctive relief against any further collection efforts by the IRS. The IRS moved unsuccessfully to dismiss the complaint, and the debtors later moved for summary judgment. After hearing oral argument, the bankruptcy court granted the debtors' motion and enjoined further IRS collection efforts.

The IRS appealed to the district court, which, following oral argument, affirmed the orders of the bankruptcy court. In an unpublished opinion, the district court held that the IRS was equitably estopped from asserting claims for which it had not given notice during the Chapter XI proceeding. The district court reasoned that the debtors had relied to their detriment on the assumption that such claims would not be asserted following completion of the plan. The district judge further held that the bankruptcy court had been empowered to enjoin the collection efforts by the IRS, notwithstanding the prohibition against such injunctions contained in 26 U.S.C. §7421(a) (1976), on the ground that the rehabilitative purpose reflected in the bankruptcy act overrides the force of the anti-injunction statute.

On this appeal, the IRS argues that the bankruptcy court had no jurisdiction to reopen the arrangement proceedings solely for the purpose of enjoining the collection of penalties and interest on the debtors' nondischargeable tax debts. The IRS further contends that the district court incorrectly held that the failure of the IRS to give notice during the proceedings of its intention to collect pre-petition penalties and post-petition interest barred collection of these sums following completion of the plan. Even if there were jurisdiction and even if the government is not equitably estopped, the IRS urges that the district court was mistaken in upholding the injunction issued by the bankruptcy court.

We vacate the judgment of the district court and remand.

II. JURISDICTION

The initial issue before us is whether bankruptcy courts are vested with jurisdiction to adjudicate the personal liability of an arranged debtor who seeks declaratory and injunctive relief against collection of tax claims in a reopened proceeding. We note at the outset that this question, like all others in the present case, is governed not by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 11 U.S.C.A. §§101-151326, but by the old Bankruptcy Act (formerly codified at 11 U.S.C.). Although the 1978 Act took effect on October 1, 1979, the Act's savings provision provides:

> A case commenced under the Bankruptcy Act, and all matters and proceedings in or relating to any such case, shall be conducted and determined under such Act as if this Act had not been enacted, and the substantive rights of parties in connection with any such bankruptcy case, matter, or proceeding shall continue to be governed by the law applicable to such case, matter, or proceeding as if the Act had not been enacted.

Pub. L. No. 95-598, §403(a), 11 U.S.C.A. §101. The present controversy has consistently been characterized by the parties, the bankruptcy court, and the district court as a reopening of the proceedings begun in 1974, and we are asked to adjudicate rights and liabilities that stem from the plan of arrangement entered into as a result of those proceedings. We believe the savings provision of the 1978 Act requires that the proceedings on reopening "shall continue to be governed by the law applicable to" the proceedings initiated in 1974. Also, we note that on May 18, 1978, when the debtors applied to

the bankruptcy court for the order reopening the proceedings, the 1978 Act was not yet in effect. Under these circumstances, we conclude that the old Bankruptcy Act must be applied.

In no case brought to our attention has the jurisdictional question been squarely addressed.[1] Nonetheless, §2a(2A) of the old Act (formerly codified at 11 U.S.C. §11a(2A)) appears to have vested the bankruptcy courts with jurisdiction to resolve the validity of claims for tax penalties and interest assessed against a debtor. That section confers on courts of bankruptcy jurisdiction to "[h]ear and determine . . . *any question* arising as to the amount or legality of any unpaid tax, whether or not previously assessed" (emphasis added).[2] Further, this jurisdiction is not defeated simply because the estate was closed following the 1976 arrangement, since bank-

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1. In *In re* Jaylaw, No. 79-5062 (2d Cir. filed May 5, 1980), the bankruptcy court reopened a Chapter XI proceeding solely to determine the validity of claims against the rehabilitated debtor for pre-petition penalties and post-petition interest that had been brought against the debtor after consummation of a plan of arrangement. The Court of Appeals for the Second Circuit, after noting that a jurisdictional objection had been raised and rejected below, proceeded to dispose of the case on substantive grounds. Slip op. at 2745-46.

2. Jurisdiction in the bankruptcy courts over debtor liability is also supported by an analysis of the consequences that might occur if the bankruptcy court did not possess such authority. The personal liability of a debtor can be a critical factor in the determination by a bankruptcy court whether it is appropriate to confirm a Chapter XI plan of arrangement. The absence of bankruptcy court jurisdiction to ascertain debtor liability could result in the confirmation of a plan of arrangement that the court might have deemed infeasible had it been able to take into account the future liability of the debtor. Such a result would be at odds with the intent of Congress in conferring bankruptcy court jurisdiction to effectuate debtor rehabilitation under Chapter XI.

Additionally, as this very case illustrates, the adjudication of claims against a debtor, no less than of those against his estate, is laden with tension between the goal of debtor rehabilitation and

ruptcy courts are vested with broad discretion to reopen cases after an estate has been administered. *See, e.g.*, In Re Seats, 537 F.2d 1176 (4th Cir. 1976). Section 2a(8) of the old Act (formerly codified at 11 U.S.C. §11a(8)) authorizes bankruptcy courts to "reopen estates for cause shown," and Bankruptcy Rule 515 provides that "[a] case may be reopened on application by the bankrupt, or other person to administer assets, to *accord relief to the bankrupt*, or for other good cause" (emphasis added). We read §§2a(2A), 2a(8) and Bankruptcy Rule 515 as conferring on courts of bankruptcy jurisdiction to reopen a closed estate for the purpose of providing "relief to the bankrupt" by adjudicating the bankrupt's personal liability for tax penalties and interest.

III. INJUNCTIVE AND DECLARATORY RELIEF

The next question we resolve is whether the bankruptcy court was authorized to grant the equitable relief requested by plaintiffs. The IRS urges that a bankruptcy court is prohibited from enjoining IRS collection efforts, and that the district court therefore erred in sustaining the injunction issued by the bankruptcy court. 26 U.S.C. §7421(a) states in pertinent part:

> Except as provided in sections 6212(a) and (c), 6213(a), and 7426(a) and (b)(1), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person . . .

Although the district court found the exemptions stated in §7421(a) inapplicable to this case, it nevertheless held that the bankruptcy court had properly en-

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that of satisfaction of creditor interests. Because bankruptcy court expertise extends to the accommodation of competing interests that is required where the personal liability of a debtor is at issue, there is considerable merit in having the bankruptcy court adjudicate all claims that jeopardize a debtor's rehabilitation.

joined the IRS collection efforts on the ground that the case fell within the ambit of *Bostwick v. United States*, 521 F.2d 741 (8th Cir. 1975), which represents a judicially created exception to the strictures of §7421(a). In *Bostwick*, the Court of Appeals for the Eighth Circuit, in upholding the issuance of an injunction against collection of taxes from a bankrupt, declared that the rehabilitative purpose of the Bankruptcy Act outweighs the force of §7421(a). The court stated:

> We believe that the overriding policy of the Bankruptcy Act is the rehabilitation of the debtor and we are convinced that the Bankruptcy Court must have the power to enjoin the assessment and/or collection of taxes in order to protect its jurisdiction, administer the bankrupt's estate in an orderly and efficient manner, and fulfill the ultimate policy of the Bankruptcy Act.

521 F.2d at 744. Inasmuch as we are of the opinion that judicially created exemptions to §7421(a) contravene clear congressional intent, it is unnecessary to address the question whether the factors held controlling in *Bostwick* are present here.

Congress has not chosen to include bankruptcy court adjudications within the exceptions to §7421(a). Indeed, Congress most recently enacted additional exceptions to §7421(a) on November 2, 1966, *see* Pub. L. No. 89-719, Title I, §110(c), 80 Stat. 1144, only four months after conferring on bankruptcy courts through 11 U.S.C. §11a(2A), Pub. L. No. 89-496, §1, 80 Stat. 270 (July 5, 1966), the power to "hear and determine . . . any question arising as to the amount or legality of any unpaid tax." Had Congress wished its 1966 amendments to the Bankruptcy Act to authorize bankruptcy courts to issue injunctions against the collection of tax, we believe this intention would have been reflected in the amendments to 26 U.S.C. §7421(a) enacted later

that year. However persuasive the arguments against application of §7421(a) to bankruptcy court adjudications may be, we believe that a bankruptcy court exemption cannot be judically fashioned without contravening congressional intent. Although there may be some merit in permitting the policy behind the Bankruptcy Act to outweigh the rationale that underpins the anti-injunction legislation, such argument should be addressed to Congress.[3] Accordingly, we conclude that the district court erred in sustaining the injunction issued in this case.

When we consider the power of the bankruptcy court to issue declaratory relief with respect to tax liability, however, a different result is compelled. The declaratory judgment provision of the federal judicial code, 28 U.S.C. §2201 (1976), specifies that "except with respect to Federal taxes, any court of the United States . . . may declare the rights and other legal obligations of any interested party seeking such declaration." The prohibition against declaratory judgments concerning federal tax claims is limited by the terms of §2201 to "courts of the United States," an expression which 28 U.S.C. §451 (1976) defines as including "the Supreme Court of the United States, courts of appeals, district courts constituted by Chapter 5 of this title, including the Court of Claims, the Court of Custom and Patent Appeals, the Customs Court and any court created by Act of Congress the judges of which are entitled to hold office during good behavior." Bankruptcy courts are not included in this enumeration and they are not courts whose judges

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3. It is worth noting that Congress, in enacting the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 11 U.S.C.A. §§101-151326, did not address the question whether bankruptcy courts may enjoin the collection of taxes, although it expressly provided that bankruptcy courts may "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax." 11 U.S.C.A. §505(a)(1).

hold office during good behavior. This suggests that they are not "courts of the United States" to which the §2201 ban on declaring federal tax liabilities applies. It is also significant that the statute forbidding issuance of *injunctions* against the assessment or collection of any tax, 26 U.S.C. §7421(a) (1976), applies to "*any* court" (emphasis added). Had Congress wished in §2201 to exclude all courts from issuing declaratory judgments regarding federal tax liability of citizens, we believe it would have followed the pattern of §7421(a). From its failure to do so, we conclude that courts of bankruptcy are not bound by the §2201 ban on the issuance by "courts of the United States" of declaratory relief with respect to federal tax liability.

Although the limitations imposed by §2201 do not apply, courts of bankruptcy, like any other courts, have no power to afford declaratory relief unless affirmatively authorized to do so by some statutory provision. We believe that this authority can be found in §§2a(2A) and 2a(15) of the old Bankruptcy Act. Section 2a(15) (formerly codified at 11 U.S.C. §11a(15)) specified that courts of bankruptcy have the power to "[m]ake such orders, issue such process, and enter such judgments, . . . as may be necessary for the enforcement of the provisions of this title." We find the power to issue declaratory judgments "necessary for the enforcement" of §2a(2A) of the Act (formerly codified at 11 U.S.C. §11a(2A)), which provides that bankruptcy courts shall "[h]ear and determine . . . any question arising as to the amount or legality of any unpaid tax." Consequently, we hold that under the old Bankruptcy Act a bankruptcy court is vested with authority to issue declaratory relief with respect to tax claims asserted against a debtor in a reopened proceeding.[4]

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4. It is significant that when Congress enacted the Bankruptcy Reform Act of 1978, it understood the former Bankruptcy Act to have conferred authority on bankruptcy courts to declare tax liability. The provision of the Reform Act explicitly granting bankruptcy

Appendix A

IV. EQUITABLE ESTOPPEL.

A. *Pre-Petition Penalties and Post-Petition Interest*

The district court held that the IRS was equitably estopped[5] from collecting pre-petition penalties and post-petition interest from the debtors in this action because of the "failure of the government to reveal its intention to make such claims in the Chapter XI proceedings, thereby misleading all participants in the arrangement who relied to their detriment upon the finality of the Proof of Claim." The IRS contends that the district court erred in applying the doctrine of equitable estoppel, and that the judgment of the district court, at least in this respect, should be reversed.[6]

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courts power to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax," 11 U.S.C.A. §505(a)(1), was said to be "derived, with only stylistic changes, from section 2a(2A) of the Bankruptcy Act" [former section 11a(2A) of Title 11]. Note of Committee on the Judiciary, Senate Report No. 95-989, reprinted at 11 U.S.C.A. §505 note.

5. The principle that estoppel may not be asserted against the government was once firmly entrenched in American jurisprudence. *See, e.g.*, Utah Power & Light Co. v. United States, 243 U.S. 389, 409 (1917); United States v. Kirkpatrick, 222 U.S. (9 Wheat.) 720, 735 (1824); Lee v. Munroe 11 U.S. (7 Cranch) 366, 369 (1813). In recent years, however, federal courts have demonstrated an increased willingness to estop the government in appropriate circumstances. *See, e.g.*, United States v. Wharton, 514 F.2d 406 (9th Cir. 1975); United States v. Lazy FC Ranch, 481 F.2d 985 (9th Cir. 1973). *See generally* Note, *Equitable Estoppel of the Government*, 79 Colum. L. Rev. 551 (1979). The doctrine of equitable estoppel as applied to tax claims in bankruptcy was initially announced in *In Re* Aristo Foods, 3 Bankr. Ct. Dec. 476 (W.D. Mo.), aff'd, 3 Bankr. Ct. Dec. 869 (W.D. Mo. 1977), *aff'd*, Nos. 77-1931 and 78-1216 (8th Cir. filed Sept. 1, 1978).

6. Our decision in Hugh H. Eby Co. v. United States, 456 F.2d 923 (3d Cir. 1972), that post-petition interest could be collected from the successor to a rehabilitated Chapter XI debtor is not dispositive of the question whether the IRS should be equitably estopped from post-consummation collection of claims of which it gave no pre-consummation notice. The proof of claim form filed in *Eby* had informed the debtor that a claim for post-petition interest would be asserted by the IRS.

Appendix A

It is well-established that obligations for pre-petition penalties and post-petition interest that accrue on a tax debt comprise personal liabilities of the debtor, and survive payment of the principal debt pursuant to an arrangement. In *Bruning v. United States*, 376 U.S. 358 (1964), the Supreme Court, confirming that post-petition interest on a nondischargeable tax debt was not allowable against a bankruptcy estate,[7] held that such claims could be asserted against the discharged bankrupt. The Court reasoned that the policies underlying the prohibition against the collection of post-petition interest claims against a bankruptcy estate — avoidance of diminution of the amount payable to competing creditors and administrative convenience — are inapplicable where the personal liability of the debtor is involved. *Id.* at 362-63. In *Hugh H. Eby Co. v. United States*, 456 F.2d 923 (3d Cir. 1972), we held that the rule of *Bruning* is applicable to a Chapter XI arrangement.[8] On the basis of *Bruning*, we reasoned that Congress, in determining that tax debts were nondischargeable,[9] had made a judgment that the importance of financing the government outweighs the "value of giving the debtor a fresh start." *Id.* at 925. *Eby* extended the *Bruning* rationale by declaring that the rehabilitative purpose of the Bankruptcy Act was not an obstacle to holding the Chapter XI debtor personally liable for post-petition interest on a tax debt where the debtor had acquired assets subsequent to confirmation of a Chapter XI arrangement.

In similar fashion, although claims for pre-petition penalties on a tax debt are not allowable against a bankruptcy estate,[10] debtors may be held personally liable for such penalties following confirmation of a Chapter XI

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7. *See* New York v. Saper, 336 U.S. 328 (1949).

8. *Accord, In re* Johnson Electrical Corp., 442 F.2d 281 (2d Cir. 1971).

9. *See* 11 U.S.C. §523(a)(1) (Supp. 1978).

10. Simonson v. Granquist, 369 U.S. 38 (1962).

plan of arrangement. In *World Scope Publishers, Inc. v. United States*, 348 F.2d 640, 642 (2d Cir. 1965), the Court of Appeals for the Second Circuit found support for this result in the principle that "there is no reason to believe that [the] deterrent function" achieved by the imposition of tax penalties "is less worthy than the rehabilitative function served by Chapter XI proceedings."

With these principles in mind, we turn to the question whether IRS should be estopped from asserting liabilities for penalties and interest against the debtors in this case. Traditionally, an equitable estoppel has been imposed when one party has relied to his detriment on the conduct of the other party, and such reliance was justified. The record supports the conclusion that the debtors relied on the conduct of the IRS during the arrangement as signifying that the IRS would not assert claims for pre-petition penalties and post-petition interest following completion of the plan. The IRS does not deny that the debtors so relied.[11]

Nor does the IRS question that the debtors' reliance would work to their detriment if collection of the claims at issue here is permitted. That conclusion is also supported by the record and follows from an understanding of a Chapter XI proceeding. The debtors in the present action borrowed a substantial sum in order to effectuate the arrangement. This enabled them to satisfy debts and to continue to operate as a business enterprise, albeit on a smaller scale. Inasmuch as that portion of the debtors' estate which survived distribution was the minimum that could support the smaller scale enterprise, it may well be that collection of the substantial claims at issue here will render continued operations impracticable.

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11. Although the factual determination that the debtors relied to their detriment on the conduct of the IRS is implicit in the bankruptcy court's application of the doctrine of equitable estoppel, the bankruptcy court made no formal findings regarding these issues.

Had the debtors known that substantial claims would be asserted in addition to those listed on the proof of claim form, the plan might not have been proffered and the loan obligation might not have been incurred, since the purpose of the plan — sustaining the business — might not have been achieved.

What the IRS contests on this appeal is the conclusion of the district court that, as a matter of law, the conduct of the IRS justified the debtors' conclusion that the proof of claim form represented all tax claims that the IRS would assert against them. In so concluding, the district court pointed to the failure of the IRS to inform the debtors during the arrangement proceeding of its intention to assert claims for pre-petition penalties and post-petition interest reasonably induced the debtors' conclusion that the IRS would not seek to collect such sums after completion of the plan. Inasmuch as claims for pre-petition penalties and post-petition interest are nondischargeable, however, a reasonable debtor should expect that the IRS will seek to enforce such claims. Since the applicable caselaw provides that these claims may be asserted *only* as personal liabilities of the debtor, a reasonable debtor should also expect that, where such debts have been incurred, the IRS will assert the claims against the debtor personally, and not against the estate. The inverse assumption espoused by plaintiffs here — that the IRS would assert claims for pre-petition penalties and post-petition interest against the estate, or not at all — runs counter to the Supreme Court's decision in *Bruning* and our decision in *Eby*, which make clear that such claims are not allowable against a debtor's estate.

Were we to hold that the IRS was barred from asserting claims that it is entitled to collect under *Bruning* and *Eby* on the ground that it had failed to provide notice during the arrangement proceeding of its intention to seek satisfaction of the debts, we would, in effect, impose on the IRS a duty to apprise debtors of applicable judicial decisions. This we decline to do. Instead, we

conclude that the debtors in this case misconstrued the law in assuming that consummation of the arrangement would satisfy all tax claims against them, including interest and penalties, and that that circumstance does not absolve them of liability for the debts which they incurred.

The debtors also contend that the IRS is estopped from asserting claims for post-petition interest because it left blank the line on the proof of claim form marked "Dollar amount per day at which interest will accrue after date of this statement." Post-petition interest is not an allowable claim against a bankrupt's estate, however.[12] For this reason, the inclusion of an entry for this sum on a proof of claim form would not be in order. The absence of an entry for post-petition interest on the proof of claim form filed in this case should not have caused the debtors' counsel to conclude that the IRS had waived a right which it could not properly have asserted on that form — namely, the right to enforce the personal liability of the debtors.

In submitting the proof of claim form, the IRS neither waived its right to assert claims for pre-petition penalties and post-petition interest nor induced the debtors' mistaken assumption that they would not be held liable for debts of this character. We construe the form as it should have been understood by the debtors' counsel, rather than in terms of the debtors' possible confusion over its meaning. The reasoning of the Court of Appeals for the Second Circuit in In re *Jaylaw*, No. 79-5062, slip op. at 2753 (2d Cir. filed May 5, 1980), is in accord with this approach. There Judge Friendly stated:

> [P]roofs of claim in bankruptcy are not intended for him who runs; they are submitted for examination by lawyers skilled in bankruptcy law, who should be familiar with decisions of the Supreme Court and,

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12. *New York v. Saper*, 336 U.S. 328 (1949).

in this circuit, of this court. To them the statement in the proof of claim would not have been misleading.

While any hardship that may be imposed on the plaintiffs is regrettable, it would not be appropriate to penalize the IRS for the failure of plaintiffs to recognize that they were personally liable for pre-petition penalties and post-petition interest.[13] Concluding as we do that the debtors' assumption that claims for these items would not be asserted against them after completion of the plan constituted a misunderstanding that was not induced by the IRS, and that their reliance on the assumption was therefore unjustified, we hold that the district court erred in affirming the bankruptcy court's application of the doctrine of equitable estoppel to the claims of the IRS for pre-petition penalties and post-petition interest.

B. *Pre-petition Interest*

The bankruptcy court did not determine whether any portion of the sum claimed by the IRS comprised pre-petition interest on the principle tax debt. Plaintiffs contend that some portion of the claim is of this character. The doctrine of equitable estoppel has considerable merit as applied to any claim for pre-petition interest asserted by the IRS against the debtors. Pre-petition interest, unlike pre-petition penalties and post-petition interest, is recoverable against the debtor's estate in a Chapter XI proceeding.[14] Indeed, it is our understand-

13. We agree with the Second Circuit's suggestion in *In re* Jaylaw, No. 79-5062 (2d Cir., filed May 5, 1980), that the IRS should prepare proof of claim forms to make more clear to debtors that it reserves the right to assert claims for pre-petition penalties and post-petition interest after the bankrupt's arraignment is completed.

14. *See* Bankruptcy Act §63(a)(1) (formerly codified at 11 U.S.C. §103(a)(1)). See also New York v. Saper, 336 U.S. 328 (1949), where all parties agreed that tax claims against a bankrupt estate bear interest at least "until the date of bankruptcy."

ing that as part of the plan of arrangement entered into by Becker's and Needham's in 1976, the IRS collected some pre-petition interest, together with the full principal debt.

Courts that have considered the personal liability of an arranged debtor have not extended the obligation of payment to claims for pre-petition interest. Allowing claims for pre-petition interest could work to the debtor's detriment in several respects. Inasmuch as the creditors who participated in the plan of arrangement might have agreed to accept a lower distribution rate per dollar from the estate to accommodate the claim for pre-petition interest if it had been filed under the plan, the debtor might be required to pay a greater amount if the claim is asserted after the plan has been consummated. This potential for increased debtor liability should not be permitted.

Furthermore, the debtors here borrowed a substantial amount in order to effectuate the arrangement. They entered into the plan relying on a calculation, which justifiably omitted a sum for additional pre-petition interest. But for the legitimate assumption that completion of the plan would represent satisfaction of any claim for pre-petition interest that the IRS could have asserted, the debtors might not have entered into the loan agreement. If collection of the pre-petition claim after consummation would render continued business operations impracticable, the debtors would be in a worse position than if the claim had been satisfied by distribution of the estate, because they would not in the latter circumstance have incurred repayment obligations on the loan.

Under the case law, the plaintiffs were justified in assuming that the IRS had asserted all pre-petition interest claims in the proceedings begun in 1974. In view of their reliance on this assumption and the potential for economic injury that would result from allowing the government to collect such interest at this stage, we hold

that the district court did not err in affirming the judgment of the bankruptcy court insofar as that judgment declared that the IRS was estopped from collecting pre-petition interest from the arranged debtors.[15]

V. CONCLUSION

The determination by Congress that penalties and post-petition interest which accrue on a tax debt are nondischargeable represents a judgment that, at least in this context, the importance of financing the federal government outweighs the value of debtor rehabilitation. We are bound to adhere to that judgment, notwithstanding the sympathetic plight of the rehabilitated debtor who has launched a fresh beginning perhaps unaware of the vulnerability of his newly acquired assets to the collection of such debts. But where the federal government has bypassed an opportunity to enforce its statutory right to collect a nondischargeable tax debt, as when it asserts a claim for pre-petition interest after completion of a Chapter XI plan, a court-imposed estoppel against collection of such claim will not frustrate the will of Congress. Inasmuch as Congress has prohibited

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15. The factors that led us in *Eby* to decide that post-petition interest could be collected from the successor to an arranged debtor are not present in this case insofar as pre-petition interest is concerned. First, the plaintiff in *Eby* sought a holding that post-petition interest was dischargeable altogether. Such a determination would have contravened section 17 of the Bankruptcy Act (formerly codified at 11 U.S.C. §35). Here, equitable estoppel of the collection of pre-petition interest would not render such interest absolutely dischargeable; rather, it would merely limit the time within which such interest could be collected. Second, we emphasized in *Eby* that the misconstruction of the law by the successor to the debtor in assuming that he would not be held personally liable for post-petition interest did not entitle him to protection from such liability. By contrast, the plaintiffs in the present situation were justified in assuming that implementation of the plan of arrangement would satisfy any debt for pre-petition interest.

the issuance of an injunction against the collection of taxes, however, the remedy in such a case must be limited to a declaration of tax liability.

Accordingly, this case will be remanded to the district court which, in turn, shall remand the matter to the bankruptcy court with instructions to determine the portion of the sum claimed by the IRS, if any, which comprises pre-petition interest. Insofar as any part of the claim sought consists of pre-petition interest, the IRS will be equitably estopped from collection activities. The IRS will, however, be permitted to collect pre-petition penalties and post-petition interest from the arranged debtors. The portion of the district court order upholding the issuance of the injunction by the bankruptcy court will be reversed.

SEITZ, *Chief Judge*, concurring.

I agree with the majority that the bankruptcy court had jurisdiction to reopen this case to adjudicate the personal liability of the debtors. I also agree with the majority's conclusions regarding the debtors' estoppel claims. I write separately because I believe that the bankruptcy court has the power to grant injunctive as well as declaratory relief in this case. It is necessary to address this issue because the bankruptcy court will have to reach the question of an appropriate remedy if it finds on remand that part of the sum sought by the IRS consists of pre-petition interest.

Sections 2a(2A), 2a(15), and 17(c) of the old Bankruptcy Act gave the bankruptcy court jurisdiction to adjudicate the dischargeability of a tax debt and to make all necessary orders in the exercise of this jurisdiction. I agree with the opinion of the United States Court of Appeals for the Eighth Circuit in *Bostwick v. United States*, 521 F.2d 741 (8th Cir. 1975), that these sections

evidence congressional intent that the comprehensive statutory scheme governing bankruptcy overrides the general policy represented by the anti-injunction statute, 26 U.S.C.A. §7421(a) (West 1980 Supp.) and that section 7421(a) does not prohibit the bankruptcy court from granting injunctive relief in exercising its power to determine questions of dischargeability. Therefore, I believe that the bankruptcy court has the power to grant injunctive relief in this case.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B

Judgment of the United States Court of Appeals for the Third Circuit

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 79-2796

IN THE MATTER OF

BECKER'S MOTOR TRANSPORTATION, INC., a New Jersey Corporation with its principal place of business in the State of New Jersey,

Debtor,

(D.C. Bankruptcy No. B-74-2050)

IN THE MATTER OF

NEEDHAM'S MOTOR SERVICE, INC., a Delaware Corporation with its principal place of business in the State of New Jersey,

Debtor,

(D.C. Bankruptcy No. B-74-2051)

DEPARTMENT OF THE TREASURY-INTERNAL REVENUE SERVICE,

Appellant.

(D.C. Bankruptcy Nos. B-74-2050 and B-74-2051)

Appendix B

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Present:

SEITZ, *Chief Judge* and ADAMS, *Circuit Judge* and
LORD, *Chief District Judge**

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel on July 8, 1980.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed September 27, 1979, be, and the same is hereby reversed as to that portion of the said judment which upheld the issuance of the injunction by the bankruptcy court, and is hereby vacated in all other respects in accordance with the opinion of this Court. The cause is hereby remanded to the district court which, in turn, shall remand the matter to the bankruptcy court with instructions to determine the portion of the sum claimed by the IRS, if any, which comprises pre-petition interest. Insofar as any part of the claim sought consists of pre-petition interest, the IRS will be equitably estopped from collection activities. The IRS will, however, be permitted to collect pre-petition penalties and post-petition interest from the arranged debtors, all in accordance with the opinion of this Court.

ATTEST:

(Ilegible)
Clerk

September 4, 1980

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* Honorable Joseph S. Lord, III, Chief Judge, United States District Court for the Eastern District of Pennsylvania, sitting by designation.

APPENDIX C

Opinion of the United States District Court for the District of New Jersey

(Filed—September 18, 1979)

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Actions Nos. B-74-2050 and B-74-2051

IN THE MATTER OF

BECKER'S MOTOR TRANSPORTATION, INC., a New Jersey Corporation with its principal place of business in the State of New Jersey; NEEDHAM'S MOTOR SERVICE, INC., a Delaware Corporation with its principal place of business in the State of New Jersey,

Debtors,
Plaintiffs-Appellees,

v.

DEPARTMENT OF THE TREASURY-INTERNAL REVENUE SERVICE,

Defendant-Appellant.

CLARKSON S. FISHER, *Chief Judge.*

Appendix C

Appearances:

Donald H. Steckroth, Esquire
Crummy, Del Deo, Dolan & Purcell
Gateway I
Newark, New Jersey 07102
Attorneys for Plaintiffs-Appellees.

Stephen T. Lyons, Esquire
Department of Justice
Washington, D.C. 20530
Attorneys for the United States.

The government appeals two orders of the Bankruptcy Court denying its motion to dismiss the complaint, and granting summary judgment to plaintiffs. The summary judgment permanently enjoined the government from levying on plaintiffs' assets to collect certain interest and penalties, discharged the claimed debts and directed the cancellation of filed federal tax liens. No written opinion was rendered.

The issues raised on appeal are:

1) Does the Bankruptcy Court have power to enjoin the collection of penalties and interest involved here; and

2) Even if such jurisdiction exists, is defendant barred from such collection as a matter of law.

The government argues that the Bankruptcy Court was without jurisdiction to issue an injunction by virtue of Section 7421(a) of the 1954 Internal Revenue Code (26 U.S.C. § 7421(a)), which excepts certain situations not applicable here, and states:

> . . . no suit for the purpose of restraining the assessment or collection of any tax shall be main-

> tained in any court by any person, whether or not such person is the person against whom such tax was assessed.

The court in *Bostwick* v. *United States,* 521 F.2d 741 (8th Cir. 1975), settled this dispute by reference to the powers granted bankruptcy courts under 11 U.S.C. § 11 (2A) to "[h]ear and determine, or cause to be heard and determined, any question arising as to the amount or legality of any unpaid tax . . ." and stated:

> . . . We believe that the overriding policy of the Bankruptcy Act is the rehabilitation of the debtor and we are convinced that the Bankrupcty Court must have the power to enjoin the assessment and/or collection of taxes in order to protect its jurisdiction, administer the bankrupt's estate in an orderly and efficient manner, and fulfill the ultimate policy of the Bankruptcy Act.

Bostwick, at 744.

The equitable powers of the Bankruptcy Court to enjoin defendant despite its own Code prohibition was further confirmed in *In re Norman C. Verran,* 3 Bankr. Ct. Dec. 291, 296 (E.D. Mich. 1977):

> The purpose and general policy underlying Sec. 7421(a) is to avoid vexatious injunctive proceedings that interfere with the collection of taxes. This court believes that this purpose does not extend, and thus would not apply, to bankruptcy proceedings, such as this, where the government, as a claimant, has already become involved as a creditor in the proceedings on its own initiative and thus availed

itself of the Bankruptcy Court to recover payment of taxes allegedly due.

Whether or not plaintiffs framed their request for relief using the words of art "dischargeability of debts" as defendant suggests it must, in fact, that was the question before the Bankruptcy Court and it had the power to rule upon that question.

The facts reveal that both plaintiffs filed Chapter XI petitions with the Bankruptcy Court on December 12, 1974. Defendant submitted Proof of Claim against Becker's for $70,601.01 and against Needham's for $11,256.03. Needham successfully moved to reduce its obligation to $4,-191.03. A Joint Plan of Arrangement under Chapter XI was confirmed December 1, 1976 and on June 30, 1977 an Order of Distribution for Priority Creditors was entered authorizing payment to defendant of $70,601.01 on the Becker's claim and $4,191.03 on the Needham's claim. Payment of these sums was actually made and accepted shortly thereafter.

In September 1977 defendant commenced collection activities against plaintiffs for interest and penalties in the amount of $34,960.14. Plaintiffs contend that this sum consists of amounts assessed prior to October 16, 1975, the date defendant filed its Proofs of Claim, and could have been included therein. Defendant claims that the sum now sought consists of pre-petition *penalties* which are not provable debts in bankruptcy pursuant to 11 U.S.C. § 103 and only post-petition interest, which survives bankruptcy and may be asserted against the debtor individually.

There are two divergent lines of cases addressing the problem presented here. Defendant relies upon *Bruning*

v. *United States,* 376 U.S. 348 (1964) and its progeny, which includes *Hugh H. Eby Co.* v. *United States,* 456 F.2d 923 (3d Cir. 1972). Briefly, these cases confirm that interest accruing on the government's tax claim between the date of filing of a petition in bankruptcy to the date of confirmation of the plan are collectible "from assets acquired by the taxpayer subsequent to the confirmation of the plan", and this is true despite the fact that the tax itself is fully paid. *Eby,* at 925.

Plaintiffs cite as authority for their position the analogous decision of *In Re Aristo Foods, Inc.,* 3 Bankr. Ct. Dec. 476 (W.D. Mo. 1977), *Aristo Foods, Inc.* v. *United States Internal Revenue Service,* 3 Bankr. Ct. Dec. 869 (W.D. Mo. 1977), *aff'd.,* unpublished opinion (8th Cir. 1978). These rulings barred collection by IRS of post-petition interest and penalties against the insolvent debtor for failure of the government to reveal its intention to make such claims in the Chapter XI proceedings, thereby misleading all participants in the arrangement who relied to their detriment upon the finality of the Proof of Claim.

The record below clearly supports plaintiffs' contention as to the nature of the assessment. The claims against Needham cover tax periods designated as 9/30/74 through 12/31/74; Becker, 9/10/73 through 12/31/74. The dates of these assessments as set forth on the federal tax liens are no later than 10/8/75, eight days before filing of the Proofs of Claims in bankruptcy. Obviously, defendant's reliance on *Eby* is misplaced, since interest accruing prior to submission of its claim was includable therein pursuant to 11 U.S.C. § 103.

If in fact the bankruptcy court had found the tax assessed by defendant to be properly recoverable, it would

have been necessary to resolve whether the levies were made against the estate of the bankrupt, or against after-acquired assets. The former is prohibited; the latter is not.

My scope of review is limited to a "clearly erroneous" standard. Bankruptcy Rule 810. The Bankruptcy Court determined on the basis of *Aristo* that "there is no genuine issue as to any material fact". Order Granting Summary Judgment to Plaintiffs filed April 24, 1979. The bankruptcy judge had this matter before him from its inception; he was thoroughly and totally familiar with the parties, extent and nature of the claims and representations made by them; he supervised the formation and successful operation of the plan. I concur in his judgment and affirm the decision below.

Plaintiffs-Appellees will submit an order.

APPENDIX D

Order of the United States District Court for the District of New Jersey

(Filed—September 27, 1979)

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Action Nos. B-74-2050 and B-74-2051

IN THE MATTER OF

BECKER'S MOTOR TRANSPORTATION, INC., a New Jersey Corporation with its principal place of business in the State of New Jersey; NEEDHAM'S MOTOR SERVICE, INC., a Delaware Corporation with its principal place of business in the State of New Jersey,

Debtors,
Plaintiffs-Appellees,

v.

DEPARTMENT OF THE TREASURY-INTERNAL REVENUE SERVICE,

Defendant-Appellant.

This matter having been opened to the Court by the Department of the Treasury-Internal Revenue Service, defendant-appellant herein, by way of appeal from the Orders of the Honorable Amel Stark, Bankruptcy Judge, entered April 24, 1979, which Orders denied the defend-

ant's motion to dismiss the Complaint and granted plaintiffs Motion for Summary Judgment, and this Court having reviewed and considered the Memorandum of Law submitted on behalf of each party, and the Court having considered the opinion of the Bankruptcy Judge, and the Court having rendered its decision as set forth in its Opinion dated September 18, 1979, and for good and sufficient cause;

It is on this 27th day of September, 1979;

ORDERED AND ADJUDGED, that the appeal filed by the defendant-appellant, Department of the Treasury-Internal Revenue Service, be and the same is hereby denied in its entirety and it is further

ORDERED AND ADJUDGED, that the Orders of the Bankruptcy Court dated April 24, 1979, be and the same are hereby affirmed in all respects.

s/ CLARKSON S. FISHER, Chief Judge

APPENDIX E

Order of the Bankruptcy Court Granting Summary Judgment

(Filed—April 24, 1979)

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Actions Nos. B-74-2050 and B-74-2051

IN THE MATTER OF

BECKER'S MOTOR TRANSPORTATION, INC., a New Jersey Corporation with its principal place of business in the State of New Jersey; NEEDHAM'S MOTOR SERVICE, INC., a Delaware Corporation with its principal place of business in the State of New Jersey,

Debtors,
Plaintiffs,

v.

DEPARTMENT OF THE TREASURY-INTERNAL REVENUE SERVICE,

Defendant.

This matter having been opened to the Court upon notice of motion of summary judgment filed by Crummy, Del Deo, Dolan & Purcell, attorneys for plaintiffs, and the Court having reviewed and considered the memorandum of law and the affidavits submitted by plaintiffs in support of said motion, and the Court having reviewed and considered the

memorandum of law submitted by the attorney for the defendant in opposition to said motion, and the Court having considered all of the pleadings heretofore filed in this matter and having heard and considered the argument of counsel for plaintiffs, Donald H. Steckroth, Esq., appearing and counsel for the defendant, Stephen T. Lyons, appearing and the Court after due consideration having determined that there is no genuine issue as to any material fact and the plaintiffs as the moving parties are entitled to a judgment as a matter of law, and the Court further noting the consents of counsel as to the form of this order annexed hereto, and for good cause shown, it is

ORDERED AND ADJUDGED this 24th day of April, 1979, that the plaintiffs' motion for summary judgment in the above-captioned matter be and the same is hereby granted; and it is further

ORDERED AND ADJUDGED that the Internal Revenue Service, defendant herein, be permanently stayed and restrained from further collection activity with respect to any interest accrued after the filing of the petition together with all unpaid penalties that accrued prior to or after the filing of the petition; and it is further

ORDERED AND ADJUDGED that the penalty and interest claims heretofore asserted by the Internal Revenue Service be and the same are hereby discharged; and it is further

ORDERED AND ADJUDGED that the Internal Revenue Service be and the same is hereby directed to vacate and cancel of record the federal tax liens heretofore filed against plaintiffs arising from the assessments of the tax liabilities involved in this proceeding.

AMEL STARK
Bankruptcy Judge

Appendix E

The undersigned hereby consents to the form of the within Order.

CRUMMY, DEL DEO, DOLAN & PURCELL
Attorneys for Plaintiffs
By: DONALD H. STECKROTH

ROBERT J. DEL TUFO
United States Attorney
By: STEPHEN T. LYONS
Attorney for Defendant

APPENDIX F

Order of the Bankruptcy Court Denying Motion to Dismiss Plaintiffs' Complaint

(Filed—April 24, 1979)

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

Civil Actions Nos. B-74-2050 and B-74-2051

IN THE MATTER OF

BECKER'S MOTOR TRANSPORTATION, INC., a New Jersey Corporation with its principal place of business in the State of New Jersey; NEEDHAM'S MOTOR SERVICE, INC., a Delaware Corporation with its principal place of business in the State of New Jersey,

Debtors,
Plaintiffs,

v.

DEPARTMENT OF THE TREASURY-INTERNAL REVENUE SERVICE,

Defendant.

This matter having been opened to the Court upon the motion of the defendant, Department of the Treasury-Internal Revenue Service, for an order dismissing the plaintiffs' complaint for the stated reason that the complaint fails to state a cause of action for which the Court may

grant relief and that said complaint seeks relief which is barred by statute, and the plaintiffs, by and through their attorneys, Crummy, Del Deo, Dolan & Purcell (Donald H. Steckroth, Esq. appearing) having filed a memorandum in opposition to said motion, and the Court having heard and considered the arguments of the parties in open Court, (Stephen T. Lyons, appearing for the defendant), and the Court having reviewed and considered the memorandum of law submitted in support of defendant's motion to dismiss as well as the plaintiffs' memorandum in opposition to said motion, and the Court having determined that the complaint does not fail to state a cause of action for which this Court may grant relief, the Court noting the consents of the counsel as to the form of this order annexed hereto, and for good cause shown

IT IS ORDERED AND ADJUDGED this 24th day of April 1979, that the defendant's motion to dismiss the complaint be and the same is hereby denied.

AMEL STARK
Bankruptcy Judge

The undersigned hereby consent as to the form of the within Order.

CRUMMY, DEL DEO, DOLAN & PURCELL
Attorneys for Plaintiffs
By: DONALD H. STECKROTH

ROBERT J. DEL TUFO
United States Attorney
By: STEPHEN T. LYONS
Attorney for Defendant

APPENDIX G

Unpublished Opinion of the Eighth Circuit Court of Appeals

FOR THE EIGHTH CIRCUIT

Nos. 77-1931 and 78-1216

In Re: ARISTO FOODS, INC.,

Debtor,

ARISTO FOODS, INC.,

Plaintiff-Appellee,

v.

UNITED STATES INTERNAL REVENUE SERVICE,

Defendant-Appellant,

MAURICE J. JOHNSON, DISTRICT DIRECTOR, INTERNAL REVENUE SERVICE, and RICHARD L. BRYAN, REVENUE OFFICER, INTERNAL REVENUE SERVICE,

Defendants.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MISSOURI

Submitted: April 14, 1978

Filed: September 1, 1978

Appendix G

Before HEANEY and STEPHENSON, Circuit Judges, and WANGELIN, District Judge.*

PER CURIAM.

This is an appeal from the United States District Court for the Western District of Missouri.[1]

In September of 1973, Aristo Foods, Inc. filed a petition in bankruptcy seeking relief under Chapter XI of the Bankruptcy Act. After two years of meetings and negotiations the Bankruptcy Act confirmed a plan of arrangement. The Internal Revenue Service (IRS) participated in the proceedings and collected nearly one hundred twenty thousand dollars in back taxes. Five months after confirmation the IRS revealed its intention to collect an additional forty thousand dollars in interest and penalties. That claim is the subject of this appeal.

The debtor petitioned the Bankruptcy Court to enjoin collection of the additional taxes. The debtor argued that the IRS is barred as a matter of law from collecting penalties and post petition interest on pre-petition taxes which are paid in full under a Chapter XI plan of arrangement. *See In re Vaughan*, 292 F. Supp. 731 (E.D. Ky. 1968). The debtor also argued that, by its conduct during the Chapter XI proceeding, the IRS had waived its claim, or was estopped from collecting it, or had accepted the amount paid in satisfaction of the debt.

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* The Honorable H. Kenneth Wangelin, United States District Judge for the Eastern and Western Districts of Missouri, sitting by designation.

[1] The Honorable Russell G. Clark, United States District Judge.

Appendix G

The Bankruptcy Court enjoined collection of the debt, adopting both theories. The District Court affirmed but expressly avoided deciding whether the interest and penalties were collectible as a matter of law. The IRS has appealed.

The government's positon is essentially that, because the penalties and interest were not allowable claims against the bankruptcy estate, the IRS was not obligated to assert them during the Chapter XI proceeding. The government also was compelled to argue that the claims were not barred as a matter of law. We have considered these arguments and conclude that the IRS accepted the amounts paid in satisfaction of the total debt. Accordingly, we affirm on the basis of the district court's opinion.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit.